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# Debt-Equity Conversions, Debt-for-Nature Swaps, and the Continuing World Debt Crisis

DANIEL H. COLE\*

The world debt crisis, which erupted in 1981-82, imperiled both commercial credit banks and their sovereign debtors. Defaults on billions of dollars' worth of risky loans made it impossible for debtor countries to attract new capital for investment and economic growth, and raised the specter of massive losses—and even failure—for the creditor banks. A decade later, the debt crisis largely has abated for the commercial banks. By increasing loan loss reserves<sup>1</sup> and restructuring or converting their high-risk debt holdings, the banks have reduced substantially their financial exposure.<sup>2</sup>

Their sovereign debtors have not fared so well. The various debt restructuring agreements and conversion programs, including debt-equity and debt-for-nature swaps, have provided them some "relief" from immediate economic ruin, but no real *reduction* in net debt. Today, the large debtor nations carry far more foreign debt than when the crisis began.<sup>3</sup>

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1. "In mid-1987, a number of the major U.S. banks set aside additional, relatively substantial reserves against their problematic international loans." Michael Blackwell & Simon Nocera, *The Impact of Debt to Equity Conversion: An Explanation and Assessment of Debt-Equity Swaps*, FIN. & DEV. 15, 16 (June 1988).

2. In fact, the banks have succeeded so well in this that it may discourage them from selling on the secondary market debt obligations they still hold. See Stuart M. Berkson & Bruce A. Cohen, *Tax Implications of Debt-for-Equity Swaps*, 12 HASTINGS INT'L & COMP. L. REV. 575, 576-77 (1989). The Appendix at the end of this article shows the growth in total external debt for representative countries between 1981 and 1988.

3. On the other hand, according to a recent report of the United Nations Commission on Transnational Corporations, "[w]hile outstanding debt had risen sharply during most of the 1980's, actual (as opposed to contractual) amortization and interest payments have not." U.N. Comm'n on Transnat'l Corps., *Role of Transnational Corporations in Services, Including Transborder Data Flows: Role of Transnational Banks - Report to the Secretary General*, Multinat'l Serv., July 1990, available in LEXIS, World Library, ALLWLD File [hereinafter *UNCTC Report*]. On the rise in external debt throughout the 1980's for representative countries, see the Appendix to this article.

To be fair, proponents of debt-equity and debt-for-nature swaps never claimed that such agreements, by themselves, would solve the debt crisis; almost everyone cautioned ambiguously that debt conversion schemes were "no panacea."<sup>4</sup> Nonetheless, both the academic and popular presses have portrayed them as effective tools of debt reduction.<sup>5</sup>

This Article examines the effects of debt-equity and debt-for-nature swaps on debtor country economies during the years 1983 through 1989. Part I briefly retraces the origins of the debt crisis through the early attempts at debt restructuring. Parts II and III, respectively, examine the two major debt conversion innovations of the 1980's: debt-equity and debt-for-nature swaps. It will be seen that during the last half of the 1980's, these schemes benefitted participating banks, investors and special interest groups more than debtor countries. They neither reduced enough debt nor produced sufficient economic growth to be considered useful debt relief tools for sovereign debtors. In addition, debt swaps tended to fuel inflation, increase domestic debt and jeopardize debtor government sovereignty over domestic economies and resources. For these reasons, in the late 1980's many debtors became increasingly reluctant to participate in the new conversion schemes.

Part IV of this Article considers recent developments in debt conversion schemes and assesses their potential role in ending the debt crisis. On the one hand, debt-equity swaps appear destined for obsolescence, though not only because of sovereign debtors' concerns. As the banks reduce their exposure to risky loans, partly by restructuring debt, partly by increasing loan-loss reserves and partly by selling discounted debt on the secondary market for swaps, they are

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4. See, e.g., PEDRO-PABLO KUCZYNSKI, *LATIN AMERICAN DEBT* 170 (1988) ("the concept [of debt-for-equity] is not a panacea for the debt problem"); THE HERITAGE FOUNDATION CENTER FOR INTERNATIONAL ECONOMIC GROWTH, *CONFERENCE ON DEBT/EQUITY CONVERSION: A STRATEGY FOR EASING THIRD WORLD DEBT* 5 (1987) [hereinafter *HERITAGE FOUNDATION CONFERENCE*] (comments of Martin W. Schubert, Chairman, European Interamerican Finance Corporation) ("The debt/equity conversion scheme should not be viewed as some type of panacea that will end the debt crisis . . ."); J. Eugene Gibson & Randall K. Curtis, *A Debt-for-Nature Blueprint*, 28 COLUM. J. TRANSNAT'L L. 331, 412 (1990) ("Debt-for-nature swaps are not a panacea to the LDCs' debt and environmental problems.").

5. See, e.g., Marilyn Post, Comment, *The Debt-for-Nature Swap: A Long-Term Investment for the Economic Stability of Less Developed Countries*, 24 INT'L LAW. 1071, 1086 (1990); Claude Regin, *U.S. Calls For More Conservation Schemes For Debtor Countries*, THE REUTER LIB. REP., Nov. 2, 1989, available in LEXIS, Nexis Library, Wires File.

less anxious to sell remaining debt below market value, thereby eliminating the chief incentive for debt-equity swaps.<sup>6</sup> Even if the banks continued to sell debt on the secondary market, it is doubtful that debt-equity swaps could retire enough debt to make them a viable debt relief tool for larger debtor countries.

Debt-for-nature swaps, on the other hand, appear to be evolving into a more useful tool for truly significant debt relief. Banks will continue to finance debt-for-nature swaps long after debt-equity swaps become uneconomical; this is because the former provide additional incentives, namely, an opportunity to gain the publicity and goodwill that come from funding popular causes such as natural resource conservation.<sup>7</sup> To become a more effective source of debt relief, however, debt-for-nature swaps will have to (1) mine greater sources of debt financing than the private commercial banks have been able to provide, and (2) increase their range of applications beyond nature conservation. There are recent signs that both these conditions can and will be met. In 1990, creditor governments decided to make their publicly held debts available for the first time for swapping.<sup>8</sup> In addition, environmental organizations, such as the World Wildlife Fund, recently have begun designing debt-swap projects that go beyond conservation to environmental restoration and pollution control, where the benefits for debtor countries are clear, direct and substantial.<sup>9</sup> These developments have already reignited debtor country interest in debt-for-nature swaps. This is not to say that swaps will become a cure-all for the debt crisis, but that they may make a more significant contribution to debt relief than they have so far.

Nevertheless, Part V concludes, if the international financial community is determined to end the debt crisis, it must look beyond debt conversion schemes to more radical and more productive tools

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6. When a bank acts to reduce the amount owed to it by a debtor nation—either by renegotiating the loan on terms more favorable to the borrower, or by engaging in a swap—the secondary market in debt paper should respond by valuing the bank's outstanding debt paper more highly, since it is now more likely that the debtor nation will be able to repay the debt. This very improvement in the quality of its outstanding debt, however, renders the bank less likely to see any advantage in entering into further swaps.

7. See, e.g., Jonathan Lynn, *E. Europe Considers Debt-for-Nature Swaps*, Reuters, Apr. 2, 1991, available in LEXIS, Nexis Library, Wires File. (" 'What do we get out of it [a debt-for-nature swap]—experience, expertise, contacts and good will,' Jaap Kool, General Manager of the NMB Bank (Vienna) AG told Reuters.").

8. See, e.g., Peter Passell, *Washington Offers Mountain of Debt To Save Forests*, N.Y. TIMES, Jan. 22, 1991, at C1. See also *infra* notes 121-124 and accompanying text.

9. See *infra* notes 119-120 and accompanying text.

that actually reduce net external debt and interest payments, so that debtor countries reasonably may expect to meet their obligations without bankrupting their domestic economies. Specifically, it is time for Western governments and private commercial banks to reconsider the option of debt forgiveness.<sup>10</sup> By canceling outright a substantial portion of sovereign debt, the international financial community would enable debtor countries to create or enlarge hard currency reserves over time. Dedication of these hard currency reserves to investment and economic growth eventually could lead to improvement of the debtor countries' credit standings and make them more stable members of the international community for the future.

## I. THE WORLD DEBT CRISIS OF 1981-82

John Maynard Keynes reputedly said that if a customer owes the bank £100, the customer has a problem; if a customer owes the bank £1 million, the bank has a problem. Early in the 1980's, commercial banks found that they had a problem. After a decade of extending easy credit to countries on the theory that states, unlike business enterprises, could not go bankrupt,<sup>11</sup> Western banks and governments suddenly found many of their "customers" teetering on the brink of insolvency; debtor nations could not meet their repayment schedules. The magnitude of this episode—the amount of debt and number of nations in technical default—was unprecedented.<sup>12</sup>

The problem was worst in Latin America. Nearly the entire continent of South America, as well as Mexico, defaulted. During the 1970's, these countries constructed massive economic development programs on a foundation of easy credit made available by international commercial banks and Western governments. Between 1973 and 1983, Latin American external debt (including Mexico's) rose from about \$48 billion to about \$350 billion, amounting to fully fifty-eight percent of the gross regional product.<sup>13</sup> By late 1981, these countries found themselves caught between a rock and a hard place, as export earnings fell in the face of a deepening international

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10. James D. Robinson III, *Concluding Impressions*, in *THIRD WORLD DEBT, THE NEXT PHASE* 102 (Edward R. Fried & Philip H. Trezise eds., 1989).

11. See KUCZYNSKI, *supra* note 4, at 5 (citing WALTER B. WRISTON, *RISK AND OTHER FOUR LETTER WORDS* 1551 (1986)).

12. Steven M. Cohen, Comment, *Give Me Equity or Give Me Debt: Avoiding a Latin American Debt Revolution*, 10 U. PA. J. INT'L BUS. L. 89, 95 (1988).

13. KUCZYNSKI, *supra* note 4, at 14.

recession, while interest rates on their debts grew to "double the level of reparations that Germany found intolerable in the prewar era that produced Hitler."<sup>14</sup> The commercial banks were slow to react to the downturn in the world economy and failed to foresee its effects on their debtors' abilities to make payments. When the banks finally did react, they abruptly curtailed all new lending, precipitating the suspension of debt service, first by Mexico in August 1982; other Latin American countries quickly followed suit.<sup>15</sup>

A similar scenario played itself out in other parts of the world, such as in Eastern Europe, where debtor nations were feeling the effects of a decade of imprudent borrowing. For example, by 1981 Poland was in the midst of a steep decline in domestic production which—combined with decreasing exports to hard-currency countries, increasing inflation and an insufficient supply of raw materials, components and spare parts—made it impossible for the Polish government to meet its international debt repayment schedule.<sup>16</sup>

For Poland, as for many Latin American countries, banks and Western governments were forced to reschedule debt payments.<sup>17</sup> They had little choice. After all, as the banks knew when they made the loans, a debtor country cannot go bankrupt.<sup>18</sup> Brazil could not be forced into liquidating its assets to repay its debt.<sup>19</sup> A court judgment against the Polish government, even if one could be obtained, would be largely unenforceable. The banks' only real options were to reschedule the debts or write them off as losses, with

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14. LAWRENCE MALKIN, *THE NATIONAL DEBT* 72-73 (1987).

15. KUCZYNSKI, *supra* note 4, at 86.

16. ZBIGNIEW M. FALLENBUCHL, *THE POLISH ECONOMY IN THE YEAR 2000* 1-2 (1988).

17. See generally ILIANA ZLOCH-CHRISTY, *DEBT PROBLEMS OF EASTERN EUROPE* 105-113 (1987).

18. Pieder Könz, *The Third World Debt Crisis*, 12 HASTINGS INT'L & COMP. L. REV. 527, 529 (1989) ("There is no such institution—no chapter eleven—in international law when sovereign borrowers are concerned. The only avenue available is debt renegotiation and restructuring. . ."). Creation of a Chapter 11-like mechanism for sovereign debtors has recently been suggested. See, e.g., Benjamin J. Cohen, *An International Chapter 11*, N.Y. TIMES, Aug. 11, 1987, at A23; Ruben Sklar, Comment, *Renegotiation of External Debt: The Allied Bank Case and the Chapter 11 Analogy*, 17 U. MIAMI INTER-AM. L. REV. 59 (1985).

19. The only practical way for a country to liquidate its assets, according to economists, is to lower the standard of living of its citizens. See, e.g., DARRELL DELAMAIDE, *DEBT SHOCK: THE FULL STORY OF THE WORLD CREDIT CRISIS* 9-10 (1984). Of course, debtor nations have strong practical reasons not to default on their debts. Default can lead to seizure of assets abroad, restrictions on future borrowing, and ostracism from international trade. See John K. Shubin & Daniel J. Gibby, *The Promotion of Debt-Equity Swaps in Latin America: A Survey of the Regulatory Regimes and the International Policy Framework*, 20 U. MIAMI INTER-AM. L. REV. 31, 38 (1988).

the latter course entailing grave financial consequences for the banks, their shareholders and their managers.<sup>20</sup>

Banks and debtor nations each presumed that rescheduling debt repayments would defuse the crisis; smaller payments extended over a longer time period would allow the debtor country to invest more capital in production and economic growth.<sup>21</sup> This idea generally has proved a mistake. Rescheduling does not correct the underlying problems which prevented debtor nations from meeting repayment schedules in the first place. Indeed, rescheduling "hinders future economic development in the debtor nation by assuring that financial gains will be utilized to service the debt."<sup>22</sup> At best, debt rescheduling "temporarily stabilize[s]" strained relations between debtor and creditors.<sup>23</sup>

In the case of Poland, debt rescheduling contributed substantially to a steady increase in net debt throughout the 1980's, while the Polish government's ability to make payments steadily declined. In 1985, for example, Poland allocated \$2.5 billion to service a debt of \$29.3 billion; the following year, as Poland's debt rose to \$33.5 billion, the government could repay only \$1.96 billion.<sup>24</sup>

Finally, in 1987, several major U.S. banks set aside substantial additional loan loss reserves, tacitly acknowledging the failure of rescheduling to ease the crisis, and signalling their willingness to enter the debt swapping markets.<sup>25</sup> Attention was shifting from debt restructuring to conversion, specifically to the debt-equity swap.

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20. Many banks had made imprudent loans in excess of their net assets. For them, writing off the loans as losses would have meant instant bankruptcy. See Cohen, Comment, *supra* note 12, at 98-99. Other banks might have survived the losses, but not without suffering deep financial wounds.

21. See Cohen, Comment, *supra* note 12, at 97-98.

22. *Id.* at 100-101 (which continues, "The debtor nation thus faces dual and conflicting objectives: growth and debt service . . . . Because the amount of capital available for loans is finite, any increased commitment to debt rescheduling must result in proportionate decreases in new lending, and trade financing.")

23. Anant K. Sundaram, *Swapping Debt for Debt in Less-Developed Countries: A Case Study of a Debt-for-Nature Swap in Ecuador*, 2 INT'L ENVTL. AFF. 67, 67 (1990).

24. FALLENBUCHL, *supra* note 16, at 2. On the other hand, debt rescheduling did help improve Poland's export performance. While, in absolute terms, Poland's debt-service ratio remained poor, it did improve throughout the decade. See UNCTC Report, *supra* note 3.

25. Blackwell & Nocera, *supra* note 1, at 16.

## II. THE ADVENT OF DEBT CONVERSION SCHEMES: THE DEBT-EQUITY SWAP

### A. *Structure and Effects*

Banks and sovereign debtors originally viewed the debt-equity conversion scheme as an attempt to "make the best of a bad situation."<sup>26</sup> Since then, even a few bankers have acknowledged that debt-equity swaps ultimately provide few tangible benefits for debtors.<sup>27</sup> Most benefits flow to the creditor banks and investors with whom the swaps are arranged.

The debt-equity swap works as follows: The creditor bank, recognizing the impaired nature of the debt paper it holds, sells it at a discount on the secondary market to an investor interested in doing business in the debtor state.<sup>28</sup> The investor-cum-creditor sells the debt back to the debtor state either for an interest in some government-owned industry or for its partial or full dollar value in local currency. These proceeds are then invested locally in other ventures.<sup>29</sup>

The conversion from debt to equity theoretically relieves the debtor nation's burden of debt servicing. With debt financing, the debtor had to make regular hard-currency payments, regardless of the

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26. Derek Asiedu-Akrofi, *A Comparative Analysis of Debt-Equity Swap Programs in Five Major Debtor Countries*, 12 HASTINGS INT'L & COMP. L. REV. 537, 572-573 (1989).

27. See, e.g., HERITAGE FOUNDATION CONFERENCE, *supra* note 4, at 52 (remarks of Edwin M. Truman, Director of the International Finance Division, Board of Governors of the Federal Reserve System) ("Debt swaps *per se* are not likely to affect significantly the net external liability position of the [debtor] country, since they only substitute one form of external obligation for another. They improve a country's net external position only to the extent that the external debt is repurchased at a discount in terms of local currency. Moreover, such operations could, in the short run, increase the cash drain on the country if the swap program encouraged private capital outflows or facilitated the repatriation of capital. More broadly, the host country, which in many cases sees itself rationed out of international financial markets, must consider, in effect, whether the foreign exchange associated with a given investment inflow is best devoted to the retirement of debt or to some other purpose."). On the other hand, debt swaps may provide an intangible benefit for sovereign debtors by keeping open lines of communication between debtors and creditors.

28. Banks traditionally have not been interested in investing in debtor state economies; that is why debt-equity transactions typically involve sale of the debt paper to a third-party investor. Cohen, Comment, *supra* note 12, at 111. However, banks have recently begun to take a much more active role as investors and brokers in debt-equity transactions. See Asiedu-Akrofi, *supra* note 26, at 569.

29. However, investment options will usually be restricted by local law. Shubin & Gibby, *supra* note 19, at 44.



performance of its domestic economy. With equity financing, by contrast, the creditor/investor must rely on performance of the investment for its return; there is no guaranteed payment.<sup>30</sup> Relieved from making payments on its external debt, the debtor nation can dedicate hard currency reserves (assuming it has any) to capital investment and economic growth.<sup>31</sup> Further, growth resulting from foreign investment is fiscally healthier than growth obtained through debt financing because it tends to diversify the economy, thereby decreasing the effect of market fluctuations.<sup>32</sup> In practice, the supposed relief from debt payments has proved illusory. As local currency is exchanged for debt paper, the money supply increases, spurring inflation. According to one study, "the conversion of as little as five percent of outstanding debt to commercial banks could lead to an increase of thirty-three to fifty-nine percent in the domestic money supply."<sup>33</sup> The debtor government can float bonds to protect against inflation,<sup>34</sup> but this turns the debt-equity swap into a debt-for-debt exchange. Instead of international debt, the government winds up making payments on an internal debt, which tends to be more expensive because interest rates are usually higher on the domestic debt market (depending on rates of exchange).<sup>35</sup> Domestic debt financing also can result in "substantial crowding-out by placing

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30. *Id.* at 35.

31. *Id.* at 40, 65. As foreign debt is reduced, interest payments decrease correspondingly. However, any savings in interest payments can be offset by the investment returns which flow out the country. *Id.* at 65.

32. *Id.* at 66. Economic diversification may be further enhanced in cases where the debt-equity swap results in the privatization of state-owned industries. See Cohen, Comment, *supra* note 12, at 113. However, it has been argued that debt-equity swaps do not, in fact, result in any additional foreign investment. See *infra* note 40 and accompanying text.

33. Blackwell & Nocera, *supra* note 1, at 16. Mexican officials have alleged that inflation there increased between three and five percent for every \$100 million of debt converted to equity between 1986 and 1987. Asiedu-Akrofi, *supra* note 26, at 560. Some commentators argue, however, that the inflation threat is overstated. They claim that the effect is precisely the same as with any new foreign investment. See Cohen, Comment, *supra* note 12, at 121. Nevertheless, debtor countries concerned with inflation have limited the amount of swapping they will allow over a certain period of time. See, e.g., Asiedu-Akrofi, *supra* note 26, at 561.

34. Using bonds to finance debt purchases instead of cash will avoid inflation because the money supply should either remain stable or actually decrease. See Shubin & Gibby, *supra* note 19, at 70-71.

35. *Id.* On the other hand, international debts must be paid in hard currency, while internal debts can be paid in local currency. If the difference in value between local currency and some hard currency, such as the U.S. dollar, is wide enough, it may offset the interest rate differential. In any case, debtor nations would surely prefer to conserve their hard currency reserves for capital investment and economic growth, rather than debt servicing.

upward pressure on interest rates, thereby squeezing out domestic economic agents."<sup>36</sup> In addition, funds dedicated to repurchasing debt are not available for other important purposes, such as education or social welfare. UNICEF has reported that the world's least developed countries have cut their education budgets in recent years by about fifty percent per person, primarily to avoid falling deeper into debt.<sup>37</sup> Of course, this problem exists, to a greater or lesser extent, whether the debtor nation converts its debt to equity or simply continues to make payments on it. Either way, however, there is an unstated assumption that the debtor has the hard currency on reserve for making debt payments in the first place. In some cases, such as Poland, this assumption is unwarranted.<sup>38</sup>

Exchanging equity for debt can also create a political problem for debtor nations if foreign investors gain control over important sectors of the domestic economy.<sup>39</sup> A debtor government can avoid that effect, however, simply by enacting regulations limiting foreign investors to minority stakes in domestic companies. This, however, in turn, may diminish the attractiveness of debt-equity deals in the eyes of potential investors.

In most cases, the debtor nation realizes little *direct* benefit from a debt-equity swap. According to some critics, swaps merely subsidize foreign investment that would have occurred anyway, since investors are counseled never to make an investment at a discount that they would not have made at full value.<sup>40</sup> To the extent this is true, a debt-equity investor merely enjoys a discount that otherwise would not have been available, and which is provided ultimately by the debtor nation. The debtor, however, can share in the investors' boon by splitting the discount, *e.g.*, by taking a transaction fee off the top.<sup>41</sup> In addition, debt-equity programs can provide *indirect* benefits for sovereign debtors. Like all forms of foreign investment, debt-equity swaps can create employment and bring new technologies

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36. Blackwell & Nocera, *supra* note 1, at 17.

37. See Eve Burton, *Debt for Development: A New Opportunity for Nonprofits, Commercial Banks, and Developing States*, 31 HARV. INT'L L.J. 233, 237 (1990).

38. See *supra* note 24 and accompanying text. See also Daniel H. Cole, *Cleaning Up Kraków: Poland's Ecological Crisis and the Political Economy of International Environmental Assistance*, 2 COLO. J. INT'L ENVTL. L. & POL'Y 205, 217-20 (1991).

39. Burton, *supra* note 37, at 237.

40. See, *e.g.*, Shubin & Gibby, *supra* note 19, at 72.

41. Michael Chamberlin et al., *Sovereign Debt Exchanges*, 1988 U. ILL. L. REV. 415, 425-26.

and management expertise to the debtor country.<sup>42</sup> Moreover, by channeling debt-equity investments to export-oriented industries, debtor governments should be able to improve their balance of trade.<sup>43</sup>

Even with these various direct and indirect benefits, sovereign debtors only profit from debt-equity swaps *if* they result in a net decline in hard currency transfers out of the country. If, however, dividend payments to foreign debt-equity investors are equal to or greater than the debtor's previous interest and principal payments on the redeemed external debt, then the swap program does not benefit the debtor country at all; it merely exchanges one form of external liability for another.<sup>44</sup>

In the best of circumstances, debtor nations reasonably can expect only limited debt reduction from debt-equity swaps because only debts owed to commercial banks can be swapped for equity. Some countries owe only a minority of their debts to private commercial banks; the rest they owe directly to Western governments and multilateral development banks (MDBs) such as the World Bank and International Monetary Fund.<sup>45</sup> Governments, for political reasons, do not sell debt obligations to private investors,<sup>46</sup> and the MDBs are prohibited by their charters from doing so.<sup>47</sup> Thus, debt-

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42. *Id.*

43. Blackwell & Nocera, *supra* note 1, at 16.

44. Of course, increased export earnings resulting indirectly from debt-equity investment help to offset dividend payments abroad. *Id.*

45. Poland, whose loans have recently been partially forgiven, see *infra* notes 143-149 and accompanying text, was a prime example. See Cole, *supra* note 38, at 230. Like Poland, most African countries owe the majority of their external debts to sovereign creditors. See UNCTC Report, *supra* note 3. These African countries are also hampered by underdeveloped capital markets that "severely limit the potential of debt-equity conversions." *Id.* at 22.

46. However, in late 1990, the "Paris Club," an informal club of Western creditor nations, declared that its members were free to exchange debt for equity, nature or aid. See Konrad von Moltke, *Debt for Nature: The Second Generation*, 14 HASTINGS INT'L & COMP. L. REV. 973, 983 (1991). Shortly thereafter, the Bush Administration announced plans to sell or donate its Latin American debt holdings for nature conservation projects. See Peter Passell, *Washington Offers Mountain of Debt To Save Forests*, N.Y. TIMES, Jan. 22, 1991, at C1. See also *infra* notes 122-123 and accompanying text. So far, no government has actually offered to sell off LDC debt to private debt-equity investors. In fact, it remains unlikely that any government will do so. It is one thing for a government to donate or sell debt for some public purpose, such as a debt-for-nature swap; it is quite another for a government to sell debt to some private investor for private profit. See *infra* note 131 and accompanying text.

47. See Gibson & Curtis, *supra* note 4, at 386.

equity swaps have only limited effect in reducing the debtor nations' burdens, tending instead to be relatively more useful to the commercial banks involved.

Debt-equity swaps chiefly benefit creditor banks by reducing their financial exposure from precarious loans. For banks, carrying and continually restructuring insecure debts is an onerous burden which interferes with their ability to attract new capital. Selling off debt paper, albeit at a discount, relieves banks of this load and enables them to enter into new, safer lending agreements.<sup>48</sup> Even small debt-equity swaps (worth, say, \$1 million) that would not provide much debt relief for the debtor country nevertheless might reduce significantly the participating bank's exposure.

For American banks, the cost of entering into debt-for-equity arrangements may be high, because debt-equity transactions typically constitute accounting events. As a consequence, banks must absorb fairly substantial losses, which can extend far beyond any single transaction. It is common practice for American banks to list debts on their books at face value (principal plus interest), regardless of their actual market values. Once the bank sells some of the debt, however, a market price is set, and standard accounting practices usually (but not always) require that the bank adjust its books to reflect that price.<sup>49</sup> This reduces the net assets of the bank, affecting other potential investments and shareholder dividends.<sup>50</sup> Whether this discourages the banks from participating in debt-equity transactions is debatable. Some commentators maintain that ambiguities in accounting practices for swaps is not, and should not be, a barrier to

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48. Shubin & Gibby, *supra* note 19, at 41-42. By eliminating undesirable loans, a bank improves its short-term liquidity, enabling it to enter new agreements. *Id.* at 63.

49. HERITAGE FOUNDATION CONFERENCE, *supra* note 4, at 32 (remarks of Mr. Gerald B. Finneran, Senior Vice President, Drexel Burnham Lambert, Inc.) ("[T]he U.S. accountants and banks held a meeting and decided swapping loans constituted an accounting event, which meant the loans swapped must be marked to market. When Argentina, on the other hand, decided to swap public sector debt for private sector debt, the U.S. banks and regulators, and accountants agreed that a swap of private sector debt for public debt did not constitute an accounting event. Therefore no write-downs were necessary by the U.S. banks."). See also Cohen, Comment, *supra* note 12, at 118-119.

50. Shubin & Gibby, *supra* note 19, at 67-68. In fact, under a recent ruling by the U.S. Department of the Treasury, banks might sometimes be better off giving away their debt for charity, rather than selling it on the secondary market. Under Revenue Ruling 87-124, if a bank donates its debt holdings to a less developed country for charitable purposes, the bank may take a full-cost basis deduction in that debt. See, e.g., Tamara J. Hrynik, Note, *Debt-Nature-Swaps: Effective But Not Enforceable*, 22 CASE W. RES. J. INT'L L. 141, 141-42 (1990).

banks' participation.<sup>51</sup> In fact, despite accounting uncertainties, U.S. banks, such as Manufacturers Hanover, Bankers Trust, Security Pacific and Citicorp, increasingly have participated as brokers and investors in debt-equity swaps.<sup>52</sup> To date, however, most sales of debt paper have come from European banks and smaller U.S. regional banks with less exposure to high-risk debt, and correspondingly less to fear from uncertain accounting requirements.<sup>53</sup>

Banks outside the United States do not operate under the same accounting strictures; they do not have to write down remaining debts after selling some portion at a discount on the secondary market.<sup>54</sup> They therefore have no disincentive to participate in debt-equity transactions. Indeed, some countries have created special incentives to encourage their banks to participate. The Japanese government, for example, has ruled that debt-equity conversion profits are exempt from capital gains taxes even if the debts are converted at face value.<sup>55</sup>

For most investors, debt-equity exchanges are truly a no-lose situation, offering increased profit potential on investments they would have made anyway.<sup>56</sup> In addition, debt-equity swaps sometimes provide investment opportunities otherwise unavailable in markets that, under other circumstances, would be closed.<sup>57</sup> Of course, investing in debtor nations usually involves substantial political and economic risks,<sup>58</sup> but the magnitude of these risks is

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51. HERITAGE FOUNDATION CONFERENCE, *supra* note 4, at 63 (remarks of Mr. Ronald F. Harnek, Partner in the Executive Office, Peat Marwick Main) ("Accounting does not drive a transaction, and accounting should not drive a transaction.").

52. See Asiedu-Akrofi, *supra* note 26, at 569. The United States government has recently entered into the accounting debate, in an effort to encourage banks to swap debt. The authorities decided that banks can continue to carry loans on their books at face value even after swapping some existing debt at the secondary market price. However, "[i]t remains to be seen whether bank accountants will accept these principles." *UNCTC Report*, *supra* note 3.

53. Blackwell & Nocera, *supra* note 1, at 15.

54. See HERITAGE FOUNDATION CONFERENCE, *supra* note 4, at 32 (remarks of Mr. Gerald B. Finneran, Senior Vice President, Drexel Burnham Lambert, Inc.) ("European accountants and regulators have also been extremely cooperative with their banks. . . . [T]hey have permitted swaps to be made without any write-downs.").

55. Asiedu-Akrofi, *supra* note 26, at 568.

56. Mexican officials have argued that as much as 80 percent of debt-equity investment would have come into the country anyway. Alan Riding, *Debt-Equity Swaps Draw Latin Criticisms*, N.Y. TIMES, Jan. 2, 1989, at A29. See also *supra* note 40 and accompanying text.

57. Chamberlin et al., *supra* note 41, at 419-20.

58. See, e.g., Shubin & Gibby, *supra* note 19, at 70.

not substantially affected by the fact that the investment is made pursuant to a debt-equity exchange, except to the extent of any local regulations restricting the use of local currency obtained through a debt-equity swap, and timing restrictions on the repatriation of investment profits.<sup>59</sup>

### B. Latin American Debt-Equity Swap Programs

Brazil pioneered the first debt-equity program in 1983. By 1987, swapping had become, in the words of one banker, "the hottest game in town."<sup>60</sup> Through the end of 1987, between \$13 and \$18 billion in Latin American debts had been traded on the secondary market.<sup>61</sup>

Chile's debt-equity conversion program is the success story to which all debt-equity proponents point. The program was established in 1985 under Chapters 18 and 19 of the Compendium of Foreign Exchange Regulations of the *Banco Central de Chile*. In the first eighteen months of biweekly debt auctions, more than five percent of Chile's net foreign debt (worth more than \$1 billion) was converted to equity,<sup>62</sup> offsetting new debt creation.<sup>63</sup> The program brought flight capital back to Chile, resulting in economic growth, and reduced the government's principal and interest payments on its debt.<sup>64</sup> Between 1985 and 1988, Chile's total external debt declined by about \$740 million, while its gross national product grew by forty-three percent to over \$20 billion, and a government deficit of

59. The most common restriction on the use of local currency obtained in a debt-equity swap requires that it be used to finance investments approved by the debtor government. *See* Asiedu-Akrofi, *supra* note 26, at 540. Virtually all debtor countries with active debt-equity swap programs restrict the repatriation of profits. For example, Chile allows repatriation of profits only after 10 years. *Id.* at 543, 554.

60. Asiedu-Akrofi, *supra* note 26, at 570 (remark attributed to Richard Marin, head of Bankers Trust's asset enhancement operation in New York).

61. *See id.* at 539 (noting, by way of contrast, that \$300 billion in Latin American debt had been restructured in the same period).

62. HERITAGE FOUNDATION CONFERENCE, *supra* note 4, at 37 (remarks of William G. Foulke, Managing Director of Bankers Trust).

63. *Id.* at 21 (remarks of Martin W. Schubert, Chairman, European InterAmerican Finance Corp.).

64. *Id.* at 46-47 (remarks of Claudio Pardo, Director of the Central Bank of Chile and Alternate Executive Director to the World Bank for Chile, Argentina, Uruguay, Paraguay, Bolivia and Peru).

\$377 million became an \$18 million surplus.<sup>65</sup> On the other hand, Chile's balance of trade decreased markedly between 1985 and 1988; exports did increase during that period, but at a slower rate than imports.<sup>66</sup>

It is unclear how much of Chile's remarkable economic performance can be attributed to its debt conversion program, which, after all, by 1989 had reduced Chile's foreign debt by merely ten percent at most.<sup>67</sup> Commentators have praised the program's structure, calling it "speedy and well-defined" and "straightforward and clean."<sup>68</sup> The Chilean program's structure, however, does not seem to differ fundamentally from the markedly less successful programs of other Latin American countries.<sup>69</sup> Its success may be less a cause than an effect of Chile's other far-reaching economic reforms.<sup>70</sup> According to Dr. Claudio Pardo, Director of Chile's Central Bank, a favorable macroeconomic climate is "essential to the

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65. WORLD BANK, WORLD TABLES 177, 179 (1989-90). Chile's total external debt was US\$20,384 million at year-end 1985, and was US\$19,645 million at year-end 1988. *Id.* at 179. Chile's 1985 GNP of 2,291.2 billion pesos, *id.* at 177, is roughly US\$14.2 billion, using the 1985 average conversion ratio of 161.08 pesos/dollar. *Id.* at 179. Chile's estimated 1988 GNP of 4,984.0 billion pesos, *id.* at 177, converts to US\$20.3 billion using the 1988 average ratio of 245.05 pesos/dollar. *Id.* at 179. Chile's government deficit at year-end 1985 was 60.7 billion pesos, while its estimated surplus at year-end 1988 was 4.4 billion pesos. *Id.* at 177.

66. Chile's resource balance declined from 80.6 billion (1980) pesos at year-end 1985 to an estimated 70.2 billion (1980) pesos at year-end 1988. *Id.* at 177.

67. See HERITAGE FOUNDATION CONFERENCE, *supra* note 4, at 15 (remarks of Carl W. Ludvik, Cofinancing Advisor for Commercial Banks at the World Bank).

68. *Id.* at 38 (remarks of William G. Foulke).

69. For comparative descriptions of the programs in Chile, Brazil, Argentina and Mexico (as well as the Philippines), see Asiedu-Akrofi, *supra* note 26.

70. Throughout the late 1970s, Chile experimented with market-based economic reforms, but achieved mixed results. See generally Stephany Griffith-Jones, CHILE TO 1991: THE END OF AN ERA? (The Economist Intelligence Unit Special Report No. 1073) (1987). In 1985, the same year it established its debt-equity conversion program, Chile also committed itself to a demand-based economy, to achieve balance of payments equilibrium in compliance with its agreements with the I.M.F. and the international financial community. *Id.* at 31. The I.M.F. approved an "extended fund facility" for Chile, permitting a reduction in its current account deficit and securing a balance in public finances through 1987. The extended fund facility also enabled the Chilean government to reach payment extension agreements with its private creditors. *Id.* at 32. At the same time, the government re-committed itself to gradual privatization of state-owned enterprises, focussing on selling many shares to individual small investors. *Id.* at 46. Also in 1985, Chile adopted its "Programa Trienal," which committed the government to create an export-based development strategy. See *id.* at 65. Perhaps most importantly, Chile's economy benefitted mightily from rising copper prices in the mid-1980s. KUCZYNSKI, *supra* note 4, at 202.

success of any debt conversion scheme.”<sup>71</sup> Without a pre-existing favorable macroeconomic climate, investors won’t bring their dollars in, no matter what the discounts. This has been a clear lesson of failed debt-equity swap programs in other Latin American countries, such as Brazil and Mexico.

Brazil was the first country to establish a plan for converting debt to equity. Between 1983 and 1987, debt-equity swaps had reduced Brazil’s net debt to foreign banks by an estimated \$8 billion.<sup>72</sup> While this is more than four times the amount of debt-equity conversions transacted under Chile’s successful program,<sup>73</sup> it amounts to only about six percent of the \$114.59 billion that Brazil owed to foreign banks in 1988.<sup>74</sup> In fact, the interest due annually on that debt exceeds the total amount of debt converted to equity in Brazil between 1983 and the end of 1988.<sup>75</sup> Unlike in Chile, the amount of Brazilian debt converted to equity did not even begin to offset new lending. Debt-equity conversion in Brazil did not succeed as a debt *prevention* tool, let alone a debt *reduction* tool. Between the beginning of 1983 and the end of 1988, Brazil’s total external debt increased from \$92.2 to \$114.6 billion.<sup>76</sup> Gross national product did, however, steadily increase throughout the period, and Brazil’s balance of trade surplus more than doubled between 1983 and 1988.<sup>77</sup> Nevertheless, in 1989 Brazil suspended its debt-equity program because of its failure to relieve the government’s debt burden and its inflationary impacts;<sup>78</sup> in 1988 alone, debt swaps expanded the Brazilian money supply by \$1.8 billion, “an amount equal to one-third of the monetary base.”<sup>79</sup> Brazil’s unfortunate experience with

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71. HERITAGE FOUNDATION CONFERENCE, *supra* note 4, at 47. But see KUCZYNSKI, *supra* note 4, at 192.

72. Walter D. Stuber, *The Brazilian Debt-Equity Swap Program*, 12 HASTINGS INT’L & COMP. L. REV. 613, 634 (1989).

73. Asiedu-Akrofi, *supra* note 26, at 545 (“Between June 1985 and May 1987, Chile’s external debt was reduced by about 1,888 million dollars.”).

74. WORLD BANK, WORLD TABLES 147 (1989-90).

75. Stuber, *supra* note 72, at 634.

76. WORLD BANK, WORLD TABLES 147 (1989-90).

77. *Id.* at 145.

78. Stuber, *supra* note 72, at 634 n.39.

79. Eliana A. Cardoso & Daniel Dantas, *Brazil, in LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED?* 129, 147 (John Williamson ed., 1990). The Brazilian government did try to offset inflationary pressures by issuing bonds to pay for debt buy-backs, but with high real interest rates, the net result was an increase in total debt service. *Id.* At least one economist has challenged the assertion that Brazil’s debt-equity swap program was primarily responsible for the inflation problem. William R. Cline, Senior



debt-equity swaps "illustrates why many economists have concluded that the program's risks outweigh its purported benefits."<sup>80</sup>

Mexico's experience with debt-conversion schemes was similar to Brazil's, only much shorter. Mexico's program lasted only a year-and-a-half, from April 1986 to October 1987. In that time, approximately \$1.1 billion in Mexican debt obligations were extinguished, amounting to no more than two percent of the country's total external debts.<sup>81</sup> The Mexican government scrapped the program largely because of allegations that for every \$100 million of debt converted to equity, inflation increased by between three and five percent.<sup>82</sup> It is difficult to measure the effects of such a short-lived program, and impossible to predict what might have resulted had Mexico continued the program over a longer period, but even proponents of debt conversion have admitted that debt-equity conversions could never have "scratch[ed] the surface in offsetting new debt creation" in Mexico.<sup>83</sup> The \$1.1 billion in debt converted to equity there between 1986 and 1987 amounted to only thirteen percent of new debt created during the same period of time.<sup>84</sup>

While the Latin American debtor nations have had, at best, mixed success with debt-equity conversion schemes, investors and participating commercial lenders have benefitted consistently. Many of the large banks have played the secondary market, and few if any of them "have lost money on their developing country sovereign borrowers, who remain important clients for future lending."<sup>85</sup> Indeed, the banks have been so successful at reducing their high-risk debt exposure through debt-equity swaps and other devices that their

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Fellow at the Institute for International Economics, claims that the primary culprit was increased domestic spending, as the new democratically elected regime in Brazil "engaged in patronage politics." William R. Cline, *Comment*, in *LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED?*, *supra*, at 169, 171 (citation omitted). According to Mr. Cline's figures, the debt-equity swap program only added about three percent to the money supply, "hardly enough to provoke 1,000 percent inflation." *Id.*

80. Cardoso & Dantas, *supra* note 79, at 145.

81. Asiedu-Akrofi, *supra* note 26, at 560.

82. *Id.*

83. HERITAGE FOUNDATION CONFERENCE, *supra* note 4, at 21 (remarks of Martin W. Schubert).

84. See WORLD BANK, WORLD TABLES 395 (1989-90) (growth of external debt from US\$100.88 billion at year-end 1986 to US\$109.29 billion at year-end 1987).

85. Könz, *supra* note 18, at 533-34.

incentive to swap has clearly diminished.<sup>86</sup> They are much less anxious today to sell remaining debt obligations at discount prices on the secondary market.

It is more difficult to assess how well investors have done in debt-equity swaps. Obviously, to the extent that they received discounts on investments they would have made anyway, swaps were simply a windfall for them.

### III. DEBT-FOR-NATURE SWAPS<sup>87</sup>

#### A. *The Structure and Theory of Debt-for-Nature Swaps*

In 1984, a World Wildlife Fund ecologist proposed a variation on the debt-equity swap which replaced the profit-motivated investor with an environmental organization interested in conserving natural resources in debtor countries.<sup>88</sup> This so-called debt-for-nature swap is structured in much the same way as the debt-equity swap, but instead of selling impaired debt to a private investor, the bank donates or sells it at a discount to an international environmental group. That group then transfers the debt paper to a local environmental organization within the debtor country, which assigns the paper to its government in exchange for local currency or interest-bearing bonds. Those proceeds are then administered and invested in local environmental projects.<sup>89</sup> Alternatively, the debtor nation, in exchange for the debt, may set aside conservation parks and sustainable use areas, placing them under control of the local environmental organization.

Since the first debt-for-nature swap was executed in Bolivia in 1987,<sup>90</sup> it has become most popular with the international environ-

86. See Stuart M. Berkson & Bruce A. Cohen, *Tax Implications of Debt-for-Equity Swaps*, 12 HASTINGS INT'L & COMP. L. REV. 575, 576-577 (1989).

87. This section expands on part of the author's earlier article on the potential role of debt-for-nature swaps in relieving Poland's ecological crisis. Cole, *supra* note 38, at 226-28.

88. See Thomas E. Lovejoy III, *Aid Debtor Nations' Ecology*, N.Y. TIMES, Oct. 4, 1984, at A31.

89. See Marianne Lachman, *Debt-for Nature Swaps: A Case Study in Transactional Negotiation*, 2 J. CONTEMP. LEGAL ISSUES 139, 143 (1989). Still, sovereignty issues are implicated. See *infra* note 101 and accompanying text.

90. The swap involved the purchase by Conservation International of debt nominally worth \$650,000 and its return to the Bolivian government. For its part, the government agreed to protect the Beni Biosphere and established an endowment worth \$250,000 for that purpose. WORLD RESOURCES INSTITUTE, NATIONAL ENDOWMENTS: FINANCING RESOURCE CONSERVATION FOR DEVELOPMENT (International Conservation Financing Project Report 8) 8 (1989).

mental community, the media, and the governments of developed nations as a means to conserve the natural resources of developing nations while apparently reducing their foreign debt burdens. The conservation purpose certainly carries a compelling moral and scientific appeal. Tropical forests, which "serve as a natural sink for greenhouse gases and shelter the lion's share of the world's plant and animal species,"<sup>91</sup> are disappearing at an alarming rate. If the destruction is not halted, they may all be gone within sixty years.<sup>92</sup> Of the world's remaining rain forests, fifty percent are located in Latin American countries,<sup>93</sup> most of which are under tremendous pressure, due to massive foreign debts, to exploit domestic natural resources for their economic values.<sup>94</sup> The debt-for-nature swap tackles this problem from two directions. It compels conservation in exchange for debt reduction, which, in turn, reduces the economic pressure to recklessly exploit natural resources. According to U.S. Environmental Protection Agency Chief William Reilly, debt-for-nature swaps "make more than a marginal contribution to conserving what remains of the rich flora and fauna and natural systems of debt-burdened countries."<sup>95</sup>

#### B. *The Costs and Benefits of Debt-for-Nature Swaps for Sovereign Debtors*

For debtor nations, debt-for-nature swaps have been heralded as a vast improvement over the progenitor debt-equity exchange because no assets are transferred out of the country to pay off foreign investors, and foreign interests gain no legal control over key domestic industries and enterprises.<sup>96</sup> Proponents claim that debt-for-nature swaps, like debt-equity transactions, relieve debtor nations' debt servicing burdens. As foreign debt is reduced, interest payments decrease correspondingly. Hard currencies previously dedicated to

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91. Peter Passell, *Washington Offers Mountain of Debt To Save Forests*, N.Y. TIMES, Jan. 22, 1991, at C1.

92. See Post, Comment, *supra* note 5, at 1076.

93. Gibson & Curtis, *supra* note 4, at 332.

94. See Philip Shabecoff, *Bolivia to Protect Lands in Swap to Lower Debt*, N.Y. TIMES, July 14, 1987, at C2.

95. Claude Regin, *U.S. Calls for More Conservation Schemes For Debtor Countries*, THE REUTERS LIBR. REP., Nov. 2, 1989, available in LEXIS, Nexis Library, Wires File.

96. See, e.g., Hrynik, Note, *supra* note 50, at 152-153. But, for better or worse, international environmental organizations do frequently gain effective control over property within the debtor country to the extent they control or influence the local environmental organization which owns or administers the territory.

make those payments ostensibly are freed for growth-inducing capital investment.<sup>97</sup> So far, however, the average debt-for-nature swap has reduced debt by only between \$1 and \$5 million<sup>98</sup>—too little to buy any economic growth. In many cases, swaps merely reduce slightly the debtor nation's obligation to pay out funds it did not have in the first place.

Moreover, like debt-equity transactions, debt-for-nature swaps tend to be either inflationary or require the debtor nation to take on expensive domestic debt.<sup>99</sup> The debtor government can avoid these alternative problems if, instead of purchasing the debt paper with local currency, it simply cedes lands to the local environmental organization for conservation. This option, however, implicates questions of sovereignty and democratic governance. These questions are not merely theoretical. In Bolivia, Conservation International, a local environmental group which gained control over forest lands under a debt-for-nature swap, failed to consult with local residents about its conservation plans. Inevitably, its administration of the area outraged indigenous groups dependent on the forests for food and fuel, creating political headaches for the Bolivian government.<sup>100</sup>

There is also substantial doubt as to how much control an environmental organization actually obtains over the land or resources a debtor government assigns to it pursuant to a debt-for-nature swap. According to a resolution of the United Nations General Assembly, states *always* retain ultimate sovereignty over their natural resources, regardless of private property rights; this sovereignty cannot be ceded

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97. Cohen, Comment, *supra* note 12, at 112 n.169.

98. *Debt-for-Nature Swaps Not Applicable to Brazil*, *Ecologist Says*, THE REUTERS BUS. REP., Nov. 3, 1989, available in LEXIS, Nexis Library, Wires File.

99. A minority of commentators maintain that the inflation threat is overstated. They claim that the effect is precisely the same as with any new foreign investment. See Cohen, Comment, *supra* note 12, at 121. However, the experiences of some Latin American countries, such as Brazil and Mexico, with debt-equity conversion programs belie this. See *supra* notes 72-84 and accompanying text.

100. See Burton, *supra* note 37, at 242-43. The Amazon Indians have since banded together, creating an organization known as "Coordinadora de las Organizaciones Indígenas de la Cuenca Amazónica" (Indigenous Peoples' Organizations in the Amazon) (hereinafter "COICA"). COICA represents nearly 1.2 million people from Peru, Bolivia, Ecuador, Brazil and Columbia, fighting for the recognition of indigenous property rights and a role in the international political process. The group has criticized environmentalist groups operating in the Amazon, who, they claim, "have shown a single-minded devotion to preserving the environment, but not enough to the people who live there." Seema Sirohi, *Environment: Amazon Indians Say Indigenous People Left Out*, INTER PRESS SERV., Oct. 19, 1989, available in LEXIS, Nexis Library, Wires File.

or diluted.<sup>101</sup> In practice this provision might not interfere with debt-for-nature swaps, but it does reflect some very real enforceability problems.

The first debt-for-nature swap, between Conservation International and the government of Bolivia, contained no enforcement provisions.<sup>102</sup> Should the Bolivian government ever decide to renege on its promise to conserve the land, the environmental organization would have no legal recourse. Fortunately, the Bolivian government has kept its promises; in fact, no government yet has reneged on a debt-for-nature agreement. Still, there have been less extreme, but nonetheless significant, compliance problems. Some debtor governments, in countries suffering from inflation, purposefully (and probably sensibly under the circumstances) have retarded the process of enacting protective legislation and laying out local currency pursuant to debt-for-nature swaps; such foot-dragging has significantly diluted the ecological benefits the swaps promised.<sup>103</sup>

Enforcement problems aside, debt-for-nature swaps thus far have proven useful only in a narrow range of environmental situations, often corresponding only to the political interests of the environmental organizations promoting the swaps. To the extent that a debtor nation has had different environmental priorities than conservation, debt-for-nature swaps have provided no help at all. Thus, for a heavily indebted country like Poland, where pollution control and clean-up is a critical priority,<sup>104</sup> debt-for-nature swaps have had little to offer. The one swap completed there to date conserved a relatively unspoiled wetlands. In a country where forty percent of all water is too polluted even for industrial use, where the soil in some regions are so toxic that up to sixty percent of the food it yields is unfit for human consumption, and where scientists predict that twenty-five percent of all Poles will contract some form of pollution-related cancer by the year 2000, it is wasteful to spend scarce funds to create a wetlands preserve.<sup>105</sup> Fortunately for Poland and other heavily

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101. G.A. Res. 1803, U.N. GAOR, 17th Sess., 119th plen. mtg., U.N. Doc. A/5344/Add.1/A/L.412/Rev.2 (1962), *reprinted in* 9 UNITED NATIONS RESOLUTIONS 107 (Dusan J. Djonovich ed., 1974).

102. See Hryn timer, Note, *supra* note 50, at 156.

103. Gibson & Curtis, *supra* note 4, at 357 n.124. See also Michael Potier, *Swapping Debt for Nature*, OECD OBSERVER, August 1990, available in LEXIS, World Library, ALLWLD File.

104. See Cole, *supra* note 38, at 208-16.

105. *Id.* at 213-215, 243.

polluted debtor countries, the situation is changing. To their credit, the environmental groups that design and promote swaps recently have started to broaden their scope to promote not only nature conservation, but also environmental clean-up and pollution control.<sup>106</sup> This should counteract the perception in some debtor countries that international environmental organizations are less interested in the environment than in gaining political control over debtor country resources.<sup>107</sup>

Still, debt-for-nature swaps have not yet proven economically beneficial for debtor countries. Between 1987, the year of the first debt-for-nature swap, and 1990, about \$100 million worth of debts were converted for resource conservation.<sup>108</sup> This is less than one one-thousandth of overall Third World indebtedness,<sup>109</sup> or about one percent of Brazil's annual interest payments.<sup>110</sup> Even proponents of debt-for-nature swaps admit that the combined effect on total debt of all the swaps undertaken so far has been negligible.<sup>111</sup> Once again, a major reason is the limited scope of debt-for-nature swaps—there is only so much land suited and available for conservation. If debt-for-nature swaps were extended to other purposes, such as pollution control or clean-up, they might become greatly more useful to debtor countries. The problem then would not be finding enough projects, but finding enough funding.<sup>112</sup>

#### IV. RECENT DEVELOPMENTS AND THE FUTURE OF DEBT CONVERSION SCHEMES

In the late 1980s, debtor countries increasingly criticized debt relief schemes, including both debt-equity and debt-for-nature swaps,

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106. See *infra* note 119 and accompanying text.

107. See, e.g., Marlise Simons, *Brazil, Smarting from the Outcry over the Amazon, Charges Foreign Plot*, N.Y. TIMES, Mar. 23, 1989, at A14; Burton, *supra* note 37, at 242.

108. WORLD RESOURCES INSTITUTE, *supra* note 90, at 8.

109. Michael Potier, *Swapping Debt for Nature*, OECD OBSERVER, August 1990, available in LEXIS, World Library, ALLWLD File.

110. See *supra* notes 74-75 and accompanying text.

111. Gibson & Curtis, *supra* note 4, at 412.

112. A further limitation on the usefulness of debt-for-nature agreements is the fact that before 1990, all debt conversion schemes, including debt-for-nature swaps, were financed by private commercial banks. For political reasons, sovereign creditors never sold or donated their debt holdings for any purpose. As a result, countries like Poland and most countries in Africa, which owe the vast majority of their debts to creditor governments, could not realize enough debt reduction to make the debt-for-nature swap a truly useful debt relief tool.

for failing to reduce net debt and aggravating domestic economic woes. In 1989, two Brazilian economists, Arno Meyer and Maria Silvia Bastos Marques, conducted a study that found debt conversions resulted in a net balance-of-payments loss for their country; they concluded that debt swaps ultimately were harmful to Brazil.<sup>113</sup> That same year, Mauro Victor, a leading Brazilian ecologist, affirmed that debt-for-nature swaps had little utility for his country, " 'given the size of the country and the magnitude of its external debt.' " <sup>114</sup> Finally, in July 1989, the government of Brazil declared a unilateral moratorium on interest payments to its commercial creditors.<sup>115</sup> In other countries, such as Mexico, officials argued that debt swaps replace, rather than stimulate, traditional investment.<sup>116</sup> And Polish officials warned against selling potentially valuable state-owned properties at bargain prices in exchange for slight debt relief.<sup>117</sup> Instead, debtor nations called for *real* debt reduction.

The statistics on commercial bank-funded debt relief seem to bear out the debtors' concerns. In a recent report to the Secretary General of the United Nations, the U.N. Commission on Transnational Corporations concluded:

The role played by transnational banks through the end of 1988 brought about practically no respite for debtor countries. It will be recalled that although commercial bank claims on 17 major debtor countries (including Hungary and Poland) declined by over \$20 billion between 1987 and 1988, the claims in 1988 were \$56 billion more than in 1982. Debt service as a proportion of exports of goods and services in 1988 for 15 major debtor countries, excluding Hungary and Poland, was nearly 40 percent and was much higher for the latter two countries. The net

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113. See Alan Riding, *Debt-Equity Swaps Draw Latin Criticisms*, N.Y. TIMES, Jan. 2, 1989, at A29.

114. *Debt-for-Nature Swaps Not Applicable to Brazil, Ecologist Says*, THE REUTERS BUS. REP., Nov. 3, 1989, available in LEXIS, Nexis Library, Wires File.

115. After a year-and-a-half, this moratorium was finally lifted at the end of 1990. See Jonathan Fuerbringer, *Brazil Says It Will End Its Debt-Payments Ban*, N.Y. TIMES, Dec. 18, 1990, at C2.

116. Riding, *supra* note 113 (" 'I would say that at least 80 percent of this money would have come into Mexico anyway,' one senior official said, 'So why should we subsidize it?' ").

117. *International Finance, Debt-Equity Swaps Not a Present Option for Poland, Says Official*, DAILY REP. FOR EXECUTIVES (BNA), June 5, 1990, at A6, available in LEXIS, Nexis Library, NWLTRS File.

transfer of resources from the 15 major indebted countries to the rest of the world has varied between 3-5 percent of gross national product (GNP); this has been an important factor leading to a decline in investment, per capita consumption and expenditure on vital social services, such as health and education.<sup>118</sup>

The inescapable conclusion is that, to date, the world debt crisis has not been significantly alleviated by the myriad debt restructuring and conversion schemes, including debt-equity and debt-for-nature swaps. That does not mean, however, that all of these remedies should be summarily scrapped. There is, in fact, good reason to hope that debt-for-nature swaps, in particular, can be a more effective debt relief tool in the coming decade than they have been so far.

This hope stems from two developments that took place in 1990. First, environmental organizations began expanding debt-for-nature swaps beyond conservation to meet the specific environmental needs of debtor countries. The World Wildlife Fund began work on a plan to help clean up Poland's Vistula River. This swap will generate only about \$50,000 in debt reduction,<sup>119</sup> but its significance far exceeds its size. The Vistula swap may inspire more extensive use of debt-for-nature swaps in Poland and other countries, since it apparently offers a model for retiring truly significant amounts of debt over long periods of time. Not all debtor nations have land areas lending themselves readily to the classic, conservation-oriented, debt-for-nature swap; on the other hand, all debtor countries certainly do have particular environmental problems the resolution of which might be encouraged by swaps similar to the Vistula agreement. This new model gives debtor countries renewed incentive to participate in swaps. Historically, sovereign debtors, especially in less developed countries, have tended to view resource conservation as chiefly beneficial to the developed world;<sup>120</sup> they have not perceived

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118. *UNCTC Report*, *supra* note 3 (footnote & table omitted).

119. See Hilary F. French, *Green Revolutions: Environmental Reconstruction in Eastern Europe and the Soviet Union*, *WORLDWATCH PAPER* 99, at 48 (Nov. 1990).

120. Indeed, many leaders of less developed countries characterized conservationism as a form of colonialism imposed by the industrialized north. *Summit Highlights Debt-Environment Link: Amazon Pact Presidents Reject Outside Interference*, *LATIN AMERICAN REGIONAL REPORTS: BRAZIL*, June 1, 1989, at 4. For an extreme statement of this view, representative of one strain of thought in the LDCs, see Burton, *Debt-Swaps: New Game in Town*, *CHRISTIANITY & CRISIS*, Mar. 7, 1988, at 63 ("Participation in debt swaps means participation in an inequitable system that created the debt crisis . . . where Third World elites are rewarded by the North for pillaging their countries and repressing their people.").



resource conservation as directly and substantially beneficial to either their environments or their economies. Now, broadened use of debt-for-nature swaps offers the prospect of immediate and tangible benefits for these countries, including the possibility of achieving unprecedented reductions in external debt. -

The second recent development in debt-for-nature swaps is the participation of sovereign creditors. Late in 1990, the Paris Club, a consortium of Western creditor countries, authorized its members for the first time to sell or donate debts for swaps.<sup>121</sup> Almost immediately, the Bush Administration announced plans to retire Latin American debt obligations in exchange for conservation.<sup>122</sup> Environmental Protection Agency Chief William Reilly expects this plan to mobilize up to \$100 million a year for conservation.<sup>123</sup> Thus, in a single year, the United States government alone conceivably could retire as much foreign debt as all the debt-for-nature swaps undertaken up to 1990. The benefit from sovereign creditor-funded debt swaps would increase tremendously if other Paris Club members—such as Germany, Great Britain, France and Japan, each of whom hold billions of dollars in debt obligations of Latin American, Eastern European, African, and other countries—followed the lead of the United States. The German government, for example, has already agreed to retire \$60 million in Polish debts to finance environmental assistance programs.<sup>124</sup> With debt donations from sovereign creditors, debt-for-nature swaps can be expected to proliferate, greatly benefitting the environment and retiring truly significant amounts of debt.

Largely as a result of these recent developments, debtor countries that formerly criticized debt-for-nature swaps have begun espousing them. At the end of 1989, the Brazilian government, for instance, was dead set against debt-for-nature swaps; six months later, Brazilian President Fernando Collor de Mello declared that Brazil

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121. See von Moltke, *supra* note 46, at 982-83.

122. Peter Passell, *Washington Offers Mountain of Debt To Save Forests*, N.Y. TIMES, Jan. 22, 1991, at C1.

123. *Id.*

124. See French, *supra* note 119, at 48.

would welcome swaps.<sup>125</sup> By the end of 1990, Brazilian officials began to propose swaps of their own.<sup>126</sup>

Moreover, the entrance of sovereign debtors into the swap market almost certainly will fuel other kinds of public benefit-oriented debt conversion schemes. One such scheme is the "debt-for-development" swap,<sup>127</sup> which promotes health-care, educational and other developmental programs in needy debtor countries. In a debt-for-development swap, a creditor bank or sovereign creditor sells or donates debt paper to a nonprofit international organization, such as UNICEF or CARE, that already operates programs in the participating debtor country. For example, UNICEF annually spends \$3 million on programs it operates in Mexico. Under a debt-for-development arrangement, UNICEF could use those funds to purchase Mexican debt paper steeply discounted on the secondary market.<sup>128</sup> Then, UNICEF would sell the debt paper back to the Mexican government at face value or slightly less in local currency. Any amount paid by the Mexican government in excess of the secondary market price would provide UNICEF with a larger operating budget for its programs in that country.<sup>129</sup>

The main problem with debt-for-development swaps has been that few international relief organizations have budgets permitting them to purchase enough debt from private commercial banks to do much good.<sup>130</sup> Now, however, with sovereign creditors willing to

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125. See, e.g., René Villegas, *Brazil Now Favors Debt-for-Nature Swaps*, REUTERS, May 8, 1990, available in LEXIS, Nexis Library, Wires File.

126. See, e.g., Gary Marx, *Rain Forest Destruction in Brazil Slows, but Critics Remain Wary*, CHI. TRIB., Nov. 30, 1990, at 29. Brazil is not alone. See, e.g., Jonathan Lynn, *E. Europe Considers Debt-for-Nature Swaps*, Reuters, April 2, 1991.

127. See generally Burton, *supra* note 37.

128. Alternatively, the bank could donate the debt to the nonprofit, charitable agency and receive a full cost basis tax write off, under the current interpretation of the U.S. Treasury Department. Rev. Rul. 87-124, 1987-2 C.B. 205, 206. See Ronny Jay Halperin, Comment, *Revenue Ruling 87-124: Treasury's Flawed Interpretation of Debt-for-Nature Swaps*, 43 U. MIAMI L. REV. 721, 724-25 (1989).

129. Burton, *supra* note 37, at 234-235. Even Ms. Burton has doubts as to whether a vast, government-funded organization like UNICEF, subject to various political pressures, is "likely to engage in experimental programs such as debt swaps." *Id.* at 243-44. She suggests that smaller, privately funded organizations, such as Lutheran World Relief or CARE, would be more likely candidates to participate in such programs. *Id.*

130. The total debt owed by developing states to creditors in wealthier states now exceeds \$1 trillion. See Burton, *supra* note 37, at 235. In 1988, UNICEF, which is one of the world's largest nonprofit organizations, had total program expenditures of \$375 million. *Id.* at 243. Even if UNICEF were to apply its entire operating budget to purchasing debt, which is extremely unlikely, this would have only limited value as a debt reduction plan.

*donate* debt, international nonprofit organizations will not be limited by the purchasing power of their own operating budgets. The sovereign creditors should be willing to donate debt for reasons of political economy; debt donation is a relatively inexpensive way to finance foreign assistance. Meanwhile, debtor countries will benefit from the increased developmental investment—for agricultural production, health care, education, etc.—as well as from significant reductions in their external debts.

On the other hand, the participation of sovereign creditors in the swap market is likely to have little impact on debt-equity swaps. The Paris Club explicitly authorized its members to engage in debt-equity swaps, but most governments will probably choose not to do so for political reasons.<sup>131</sup> Unlike other conversion schemes, debt-equity swaps do not provide clear and direct *public* benefits in the debtor country; they mainly provide investment incentives for *private* profit. It could be a serious diplomatic blunder for any creditor government to donate or sell debt paper for private profit, especially when part, if not most, of the expense is ultimately borne by the debtor government. Furthermore, sovereign creditors, unlike private commercial banks, are incapable of participating as investors in debt-equity swaps; for obvious reasons of sovereignty, debtor countries would never permit foreign governments to obtain significant financial control over any segment of their domestic economies.

Debt-equity swaps likely will continue to be financed predominantly, if not exclusively, by private commercial banks. But, as discussed earlier,<sup>132</sup> even this funding source has already begun to dry up; because their own financial situation has improved, the banks now have less incentive than they once did to sell debt paper below face value on the secondary market. The extent of the banks' future participation can be expected to fluctuate with the markets and the banks' own financial circumstances.

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131. However, this is by no means certain. The U.S. government has been a vociferous proponent of debt-equity swap programs in the past, and it is not beyond the realm of possibility that they will back up their support with funding. In fact, the American government has been severely criticized for supporting debt-equity swaps. See, e.g., *Panel Discussion on Latin American Adjustment: The Record and Next Steps*, in *LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED?* 312, 324 (John Williamson ed., 1990) (remarks of Rudiger Dornbusch, Professor of Economics at Mass. Inst. of Tech.) ("Washington has been obscene in advocating debt-equity swaps and in insisting that they be part of the debt strategy. The U.S. Treasury has made this dogma, and the IMF and the World Bank, against their staffs' professional advice and judgment, have simply caved in.").

132. See *supra* note 86 and accompanying text.

## V. CONCLUSION AND RECOMMENDATIONS: AVOIDING A PERPETUAL DEBT CRISIS

Optimism over the potential of debt-for-nature and debt-for-development schemes to relieve the debt burdens of poor debtor countries must be tempered by the knowledge that, so far, they have not made even a dent in the world debt crisis. Almost every large debtor country today carries far more debt than when the crisis first began in 1981-82 (see Appendix). In the last year alone, total developing country debt climbed six percent to \$1.34 trillion.<sup>133</sup> Despite promising recent developments, questions remain for sovereign debtors about the economics of debt-for-nature swaps and debt-for-development schemes. According to some economists, printing money or sacrificing precious foreign exchange reserves to buy back debt is simply "bad business."<sup>134</sup> Beyond that, some needy debtors might not be able to afford in the first instance to buy back the debt paper.<sup>135</sup> Poland, for example, has plenty of potential uses for debt-for-nature swaps, but the Polish government today hardly can afford to buy back (even at a steep discount) enough of its debt paper to fund many of them.<sup>136</sup> Clearly, debt swaps alone will never end the debt crisis.

International debt analysts acknowledge that the debt crisis will end only when debtor country economies grow out of it.<sup>137</sup> To achieve sustained growth, debtor governments must adopt economic and institutional policies that promote investment while restricting inflation.<sup>138</sup> Creditors, especially Western governments, should

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133. Jube Shiver, Jr., *Economic Reforms Help Latin America Ease Its Debt Crisis*, L.A. TIMES, Dec. 26, 1990, at D1.

134. *Panel Discussion on Latin American Adjustment: The Record and Next Steps*, *supra* note 131, at 322 (remarks of Rudiger Dornbusch, Professor of Economics at Mass. Inst. of Tech.).

135. Remember, in a debt-for-nature swap an environmental organization obtains the debt paper, by sale or donation, from either a private commercial bank or, now, from a sovereign creditor. To make the swap work, the environmental organization must be able to sell (or resell) the debt paper (at face value or slightly less) to the debtor government. *See supra* note 89 and accompanying text. If the debtor country has too many needs and too few funds, debt-for-nature swaps will not work, no matter how much money sovereign creditors are willing to donate.

136. *See, e.g.*, Eugeniusz Fudlis, *Debt-for-Nature Swaps: The Business of Environmental Clean-Up*, GAZETA INT'L, Nov. 29, 1990, available in LEXIS, World Library, ALLWLD File.

137. *See, e.g.*, KUCZYNSKI, *supra* note 4, at 211.

138. *Id.*

support debtor country efforts to this end by quickly and completely removing the barrier to economic growth posed by massive pre-existing debts. In other words, they should encourage economic reforms by actually forgiving debt. By reducing net debt and, consequently, interest payments, debtors can begin to save and eventually rededicate hard currency reserves to economically productive investment.

Debt forgiveness long has been an "X-rated" term for Western governments, MDBs and private commercial banks.<sup>139</sup> They have been afraid that if they canceled one country's debts, an avalanche of forgiveness pleas would follow from others.<sup>140</sup> This is almost certainly true, but each debtor's claim could be addressed independently on its own merits; debt forgiveness can and should be restricted to debtor countries demonstrating a strong and sustained commitment to meaningful economic reforms. Creditors are also concerned that debt cancellation would create the impression that they will capitulate whenever a debtor nation has problems making payments. But this misconstrues the aim of debt cancellation; it is not a matter of mercy, but of inducement to sound economic practices, which ultimately make the debtor country a better credit risk for future lending and, in some cases, open new markets for international trade and investment. Moreover, debt forgiveness would not come without costs to debtor countries; it would be essentially an investment in their economic reforms.<sup>141</sup>

Recently, the international financial community's traditional distaste for debt forgiveness has begun to wane, as other alternatives like debt-equity and debt-for-nature swaps fail to reduce net debt substantially. Western nations have already agreed to reduce debts by up to thirty-three percent for poor African countries.<sup>142</sup> On March

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139. Robinson, *supra* note 10, at 102.

140. See, e.g., Benjamin J. Cohen, *An International Chapter 11*, N.Y. TIMES, Aug. 11, 1987, at A23.

141. Some commentators have suggested a bankruptcy-like mechanism for this kind of combined debt-forgiveness and economic restructuring. For example, Professor Benjamin Cohen, of Tufts University's Fletcher School of Law and Diplomacy, has suggested the establishment of a kind of international Chapter 11 for sovereign creditors to be administered by an "International Debt Restructuring Agency." This agency, operating like a domestic bankruptcy court, would negotiate an agreement between a distressed sovereign debtor and its creditors, granting permanent relief in exchange for enforceable economic reforms. After completing the reforms, the debtor country would have its creditworthiness restored. *Id.* See generally Sklar, Comment, *supra* note 18.

142. Steven Greenhouse, *Poland Asks West to Cancel Most of Its Big Foreign Debt*, N.Y. TIMES, Dec. 4, 1991, at C1.

15, 1991, the Group of Seven industrial nations agreed to cancel outright fifty percent of Poland's \$30.8 billion debt to member countries, in view of that country's ambitious and pioneering "shock therapy" transition from socialism to a free market economic system.<sup>143</sup> The Bush Administration went even further, reducing Poland's \$3.8 billion debt to the United States by fully seventy percent.<sup>144</sup> Thus, in one fell swoop, Poland's debt burden was cut by more than \$16 billion. The impact of this debt relief on Poland's

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143. James Risen, *Western Nations Reward Poland by Halving Its Debt*, L.A. TIMES, Mar. 16, 1991, at D1. Under the "shock therapy" program, the Polish government de-controlled all prices, set limits on wage increases, established a domestically convertible currency, and developed a plan to privatize virtually all state-owned industries and enterprises. See, e.g., Cole, *supra* note 38, at 218-219.

The Group of Seven's debt forgiveness plan for Poland was not agreed to unanimously, however. The Japanese government objected strongly to outright forgiveness of Poland's debts on grounds that it would encourage financial irresponsibility by debtor countries and set a bad precedent, leading other debtor countries to seek similar relief whenever they had any trouble meeting their obligations. The Japanese also objected to the Polish debt forgiveness plan because it was based on political considerations—Poland's conversion from socialism to a free market economic system—rather than economics. See, e.g., James Sterngold, *Japan Retreating on Promised Loans*, N.Y. TIMES, Apr. 14, 1991, at A1. To further express their displeasure, the Japanese subsequently reneged on a promised \$500 million loan to Poland. *Id.* Finally, in February 1992, the Japanese and Polish governments entered into a debt restructuring agreement. See *Japan Reschedules Polish Debt*, Kyodo News Service, Feb. 14, 1992, available in LEXIS, Nexis Library, OMNI File.

The Japanese position on Polish debt forgiveness has been called " 'unconscionable,' 'coldly financial,' and 'Calvinist.' " See Sterngold, *supra*. It is a most ironic position for a country like Japan to take, given the economic benefits it received from the West—for purely political reasons—following World War II; and it is especially ironic in view of the tragedy of Poland's plight, as the only member of the allied forces to "lose" the war, so to speak.

Japan has merely expressed the traditional arguments of creditor countries against debt forgiveness, which I discussed earlier: forgiving one country's debts could lead to an avalanche of debt relief pleas from other countries, and would encourage countries to seek debt relief at the first sign of economic difficulties. See *supra* notes 140-141 and accompanying text. Aside from these visions of doom, Japan has not explained why political motives are invalid reasons for granting debt forgiveness, which is, after all, just another kind of economic assistance. Nor has Japan explained *why* or *how* an avalanche of debt forgiveness claims would be a bad thing. Certainly, granting debt forgiveness in one case does not commit the Group of Seven to accede to every claim; each claim can be decided on its own merits. In any case, none of the major creditor countries of the world seem to share (at least, not to the same degree) Japan's concerns over the potential negative effects of debt forgiveness. Japan is the only member of the Group of Seven for whom "debt forgiveness" remains a forbidden phrase.

As this article goes to press, Japan has begun to soften its position on debt forgiveness for Poland. See *Japan May Conditionally Forgive Part of Polish Debt*, PAP News Wire, Mar. 19, 1992, available in LEXIS, Nexis Library, WIRES File.

144. Clifford Krauss, *Bush Greets Walesa With Debt Relief*, N.Y. TIMES, Mar. 21, 1991, at A3.

economic situation is sure to be significant, though it is difficult to quantify at this early stage. By way of comparison, the amount of debt reduction achieved through this single agreement is roughly 160 times the total debt reduction achieved by all the debt-for-nature swaps ever executed,<sup>145</sup> and approximately equal to the total amount of Latin American debt converted to equity over the past decade.<sup>146</sup>

U.S. debt forgiveness for Poland will also benefit the environment substantially. Pursuant to the debt forgiveness agreement, Poland must dedicate ten percent of U.S. forgiven debt (or about \$266 million) to fund environmental projects.<sup>147</sup> According to one Polish official, debt forgiveness by the United States and other creditor countries will generate roughly three billion złotych (\$300 thousand) per year for environmental protection.<sup>148</sup> This estimate soon may increase by a factor of ten. On June 11, 1991, then Polish Prime Minister Jan Krzysztof Bielecki proposed to the Paris Club the "world's largest debt-for-nature exchange scheme," which would reduce Poland's debts to Western governments by an additional ten percent, thereby generating an estimated \$3.1 billion over eighteen years for an internationally monitored environmental protection fund. Over its first three years, the plan would produce \$120 million annually for environmental protection in Poland; the amount would rise to \$300 million per year for the remaining fifteen years of the program.<sup>149</sup>

Admittedly, Poland's situation is politically unique; Western governments have a special stake in facilitating Poland's successful transition from socialism to capitalism. In the long run, however, they may find they have just as much to gain from ending the debt crisis in Africa and Latin America. Aside from the economic benefits, including increased trade opportunities, that would ultimately ensue from a combined program of debt cancellation and economic reform, Western industrialized nations would profit from the increased

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145. See *supra* text accompanying note 108.

146. See *supra* text accompanying note 61.

147. See *Przekuć, dług na ekologię* (To Swap Debt for Ecology), GAZETA WYBORCZA, Apr. 11, 1991, at 5.

148. *Id.*

149. See Alina Białkowska, *Part of Polish Debt to Be Spent on Environment*, Polish News Bulletin, June 12, 1991, available in LEXIS, Nexis Library, PNBUL File. The Paris Club has not yet acted on Prime Minister Bielecki's proposal. However, Norway, Sweden, the United States and France are all on record in support of the initiative. See Christopher Bobinski, *Poles Seek to Swap Debt for Nature*, FIN. TIMES, June 12, 1991, at 4.

regional political stability that relative economic prosperity would bring.



## APPENDIX

TOTAL EXTERNAL DEBT FOR SELECTED DEBTOR  
COUNTRIES, 1981-1988

(Source: World Bank, World Tables (1989-1990))

	1981	1982	1983	1984	1985	1986	1987	1988
	<i>(billions of 1989 U.S. dollars)</i>							
Brazil	80.6	92.2	97.5	104.3	104.6	112.0	123.9	114.6
Chile	15.7	17.3	17.9	19.7	20.4	21.1	21.5	19.6
Costa Rica	3.3	3.6	4.2	4.0	4.4	4.5	4.7	4.5
Malawi	.81	.86	.88	.88	1.0	1.2	1.4	1.3
Mexico	78.2	86.0	93.0	94.8	96.9	100.9	109.3	101.6
Philippines	20.9	24.5	24.3	24.2	26.6	28.3	30.1	29.4
Poland	.*	.*	.*	.*	33.3	36.7	42.6	42.1